

Internal Revenue Service
memorandum

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Br5:CPlambeck

date: **MAR 15 1988**

to: Dan Altman
International Examiner E:E:4:1469-DA

from: Robert A. Katcher *RAK*
Chief, Branch 5 CC:INTL:Br5

subject: Treatment of Certain Liabilities for Purposes
of Treas. Regs. § 1.882-5

This memorandum is in response to your letter of November 25, 1987 requesting our views on certain issues under Treas. Regs. § 1.882-5. Subsequent conversations with Mr. Julius Kunofsky narrowed the scope of the inquiry to whether vested but unfunded pension liabilities (which do not bear interest) of a foreign corporation (the "Pension Liabilities") should be considered as corporate liabilities for purposes of the actual ratio test of Treas. Regs. § 1.882-5(b)(2)(ii). We believe that the Pension Liabilities should not be considered as corporate liabilities for purposes of the actual ratio test of Treas. Regs. § 1.882-5(b)(2)(ii).

The language of Treas. Regs. § 1.882-5 merely states that the classification of an item as a liability be determined substantially in accordance with U.S. tax principles. We assume the Pension Liabilities satisfy this requirement.

Treas. Regs. § 1.882-5 seeks to compute the interest expense attributable to the effectively connected income of the United States branch of a foreign corporation. Generally, the theory of Treas. Regs. § 1.882-5 is that money borrowed by a corporation for a particular purpose frees other funds for other purposes, therefore the interest expense associated with such borrowing is attributable to all activities and property of the corporation. Treas. Regs. § 1.882-5 therefore takes into account the corporation's worldwide interest expense, and attributes a portion of that interest expense to the United States branch. The amount of interest expense which is attributed to the United States branch is determined by imputing liabilities to assets that generate effectively connected income and then multiplying those imputed liabilities by an interest rate. The logic of this approach dictates that the liabilities which are imputed to the branch must be interest bearing liabilities.

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Therefore, the theory of Treas. Regs. § 1.882-5 dictates that because the Pension Liabilities do not bear interest they should not be included in the computation of corporate liabilities for purposes of Treas. Regs. § 1.882-5(b)(2)(ii).

We hope this memorandum has been responsive to your inquiries and we look forward to working with you again soon.

cc: Mr. Julius Kunofsky